SUPREME COURT, U. S. FILED
JUN 21 1971
E. ROBERT SEAVER, CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1970

No. 1442

CLEMENT A. EVANS & COMPANY, INC.,
Petitioner,

vs.

A. M. KIDDER & COMPANY, INC., EDWARD M. GARRETT and WILLIAM J. McALPIN, JR.,
Respondents.

PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI

ALLEN W. POST
HUGH M. DORSEY, JR.
J. CLIFTON BARLOW, JR.
3300 First National Bank Tower
Atlanta, Georgia 30303
Attorneys for Petitioner

Of Counsel
HANSELL, POST, BRANDON & DORSEY
3300 First National Bank Tower
Atlanta, Georgia 30303

St. Louis Law Printing Co., Inc., 411-15 N. Eighth St. 63101 314-231-4477

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Petitioner, Clement A. Evans & Company, Inc., prays that this Court grant rehearing of its order of May 17, 1971, denying the petition for writ of certiorari and that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit in the above-entitled case as prayed for in the petition filed March 5, 1971, herein.

REASONS FOR GRANTING REHEARING AND ISSUING THE WRIT

1. At least three recent Federal Court decisions have had occasion to wrestle with the issue of the type of reliance, if any, required to sustain a private civil action for damages based on Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. It is precisely this issue which forms the basis of the sole question presented herein, *viz.*, whether, in a private civil action for a willful and intentional fraud based on the statute and the Rule, a plaintiff's contributory negligence or failure to exercise reasonable diligence to discover the fraud and protect itself therefrom will bar recovery?

The holding of the Court below not only requires *some* reliance, as most of the authorities seem to require and as stated in *Baumel v. Rosen,* 283 F. Supp. 128, 140 (D. Md. 1968), *aff'd in part, rev'd in part,* 412 F. 2d 571 (4th Cir. 1969), *cert. denied,* 396 U. S. 1037, 90 S. Ct. 681 (1970), but, rather, the restrictive minority common law view of reliance which includes, as a part thereof, the further requirement that the defrauded party must allege and prove that he exercised reasonable care, or due diligence, in discovering the misrepresentation and protecting himself therefrom.

The first of these recent decisions is that of *Chasins v. Smith, Barney & Co.,* CCH Fed. Sec. L. Rep. ¶ 92,962 at p. 90,555 (2d Cir. March 2, 1971), a case decided only three days prior to the date on which the petitioner filed its petition for writ of certiorari. There, the court equated "adequate reliance" with "causation in fact" and noted the existing state of confusion concerning the reliance requirement by using such language as: "To the extent that reliance is necessary for a finding of a 10b-5 viola-

tion. . . ." *Id.* at 90,559. It is significant to note that, while there was no evidence of intentional fraud in *Chasins,* the case was decided by the United States Court of Appeals for the Second Circuit, the same court which first formulated the unrelated "in connection with" test which, as discussed in detail in the petition for writ of certiorari, was borrowed by the court below and erroneously relied upon in rendering the decision here complained of.

Another of these recent decisions is *Johns Hopkins Univ. v. Hutton,* CCH Fed. Sec. L. Rep. ¶ 93,033 at p. 90,824 (D. Md. April 12, 1971), in which the subject of reliance, as related to private civil actions arising under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, was discussed in considerable detail though not decided. There, as in the case at bar, the victim of the fraud contended that *Mills v. Electric Auto-Lite Co.,* 396 U.S. 375, 90 S. Ct. 616 (1970), and *Kahan v. Rosenstiel,* 424 F. 2d 161 (3rd Cir.), *cert. denied,* 398 U.S. 950, 90 S. Ct. 1870 (1970), dispensed with the requirement of reliance in cases such as those arising under the statute and the Rule. Although the court neither accepted nor rejected this contention (it concluded that the plaintiff had, in fact, relied upon the misrepresentations and omissions of the defendant's agent), it noted that the misrepresentations and omissions were not obvious to "even the most credulous mind" and cited, in support of the quoted language, the decision rendered by the Fifth Circuit in the case at bar.

The language thus quoted does, of course, appear in the decision below where the court opined, without any citation of authority, that one should not recover on account of a "fraudulent misrepresentation, no matter how willfully and intentionally made, if that misrepresentation would tax even the most credulous mind." Appendix to

Petition for Writ of Certiorari p. A-8. In making such a statement, however, it appears that the court below was concerned not with the facts in the case at bar but with where the line may properly be drawn in an extreme hypothetical situation in which the fraudulent misrepresentation must, of necessity, be obvious to the recipient. In this respect, the petitioner suggests that, where misrepresentations are willfully and intentionally made, a plaintiff should be entitled to recover unless the truth is apparent to his observation or discoverable without effort so as to be substantially equivalent to actual knowledge of the truth. This, in effect, is the rule stated by Professor Prosser in his treatise on torts:

> Contributory negligence is properly a defense to an action based on a representation which is merely negligent; but where it is intended to mislead, the recipient is not required to investigate, and his reliance is regarded as unjustified only if the truth should be apparent to his observation, or discoverable without effort. [*Prosser, Torts* § 89 at 550. (2d ed. 1955.)]

In any event, the test suggested by the Fifth Circuit, which would deny recovery if the misrepresentation were such as would tax even the most credulous mind, is far removed from the instruction under which the case at bar was submitted to the jury and upon which the jury rendered its verdict. If permitted to stand, the decision below may well become the forerunner of a test of reliance in cases based on Section 10(b) and Rule 10b-5 notwithstanding the fact that it is by no means certain that reliance is a requirement in such cases. See, *e.g., Johns Hopkins Univ. v. Hutton, supra,* at 90,829, where the confusion of the court becomes apparent in its use of the words "Even if that 'right to rely' requirement exists in this case. . . ."

Another recent decision which tends to further cloud the issue is that of *Mitchell v. Texas Gulf Sulphur Co.*, CCH Fed. Sec. L. Rep. ¶ 93,019 at p. 90,752 (10th Cir. April 26, 1971), in which reliance was required and was found to exist in an action based on the statute and the Rule. Total recovery was denied, however, due to the widespread publication of a curative statement which, in the court's opinion, terminated the plaintiff's right to rely on the previous misrepresentation. The court thus imposed the requirement that "stockholders too act in good faith and with due diligence in purchasing and selling stock". *Id.* at 90,761.

In view of the foregoing statement, the *Mitchell* case must align itself with the case at bar for the purpose of further demonstrating a conflict among the circuits. It was noted, however, that, while in some circumstances the lack of due diligence may not be unreasonable, "under the circumstances of this case it would injustifiably extend . . . [the defendant's] liability to intolerable limits". *Id.* at 90,761. A brief comparison of the "circumstances" there involved with those present in the case at bar reveals no similarity whatsoever and, it is respectfully submitted, to deny recovery to the petitioner under the present circumstances would unjustifiably *restrict* the respondents' liability to "intolerable limits". In this respect, it must be remembered that the court below, in adopting a minority common law view of reliance, has given the statute and Rule the narrowest possible construction whereby the rights of a plaintiff to recover thereunder are more circumscribed than are the rights of a plaintiff to recover for intentional fraud at common law in a great majority of jurisdictions. As thus construed, the court below has condoned conduct by means of which one party to a securities transaction willfully, maliciously and with cunning design defrauded the other party out of some $308,000.00, pocketed the fruits of his success and walked

away leaving his victim with no recourse whatsoever, a situation which the statute and Rule were intended to discourage and prevent.

2. With each passing day, the decision below, which recognizes contributory negligence as a defense to a private civil action for intentional fraud under Section 10(b) and Rule 10b-5, becomes more important in the administration of the securities laws enacted for the purpose of avoiding frauds. At a time when the bench, bar and other concerned citizens are striving for a return to respect for law and order, the decision here complained of and which should be reviewed by this Court cannot help but lead one to believe that crime does pay and, in cases such as this, very handsomely. As stated in *Bishop v. E. A. Strout Realty Agency,* 182 F.2d 503, 505 (4th Cir. 1950), a case of common law deceit:

> There is nothing in law or in reason which requires one to deal as though dealing with a liar or a scoundrel, or that denies the protection of the law to the trustful who have been victimized by fraud. The principle underlying the caveat emptor rule was more highly regarded in former times than it is today; but *it was never any credit to the law to allow one who had defrauded another to defend on the ground that his own word should not have been believed.* [Emphasis added.]

In addition, the importance of the sole question presented should be even more apparent in view of the number of recent conflicting decisions on the subject and others which may reasonably be expected to follow.

CONCLUSION

It is respectfully submitted that this Court should review the decision rendered by the court below and resolve, once and for all, the confusion and conflicts which exist in, between, and among the various courts of this land as noted herein and in the petition for writ of certiorari. For this and other reasons set forth hereinabove and in the petition for writ of certiorari, it is respectfully urged that rehearing be granted and that, upon such rehearing, a writ of certiorari issue to the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted

ALLEN W. POST

HUGH M. DORSEY, JR.

J. CLIFTON BARLOW, JR.
3300 First National Bank Tower
Atlanta, Georgia 30303
Attorneys for Petitioner

Of Counsel:
HANSELL, POST, BRANDON & DORSEY
3300 First National Bank Tower
Atlanta, Georgia 30303

Certificate of Counsel

I hereby certify that the foregoing Petition for Rehearing is presented in good faith and not for delay and is restricted to grounds specified in Rule 58 of the Rules of this Court.

J. Clifton Barlow, Jr.